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No.

IN THE

Supreme Court of the United States

October Term, 1980

PENNSYLVANIA GAS AND WATER COMPANY,
Petitioner,

v

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Respondent.

[No. 278 January Term, 1978]

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF PENNSYLVANIA

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QUESTION PRESENTED

In an appeal taken as of right, an order of a state regulatory commission was reversed by a state appellate court which found it necessary to address only one of the constitutional issues raised. On further appeal by the state commission taken by allowance, the state's highest court reversed the lower appellate court and reinstated the original order of the state commission without reviewing or remanding even after application the other constitutional issue originally raised. May a state's highest court, consistent with the due process and equal protection clauses of the Fourteenth Amendment, act to deny the judicial review of a constitutional issue raised on an appeal as a matter of right?

LIST OF ALL PARTIES

Review is sought of the February 1, 1980 judgment and opinion of the Supreme Court of Pennsylvania in the case of *Pennsylvania Public Utility Commission v. Pennsylvania Gas and Water Company*, No. 278 January Term, 1978.[1] The parties to the proceeding below were Pennsylvania Gas and Water Company (PG&W),[2] Pennsylvania Public Utility Commission (PUC), Attorney General of Pennsylvania and Mark P. Widoff, Consumer Advocate. PG&W filed an application for reargument with respect to the February 1, 1980 judgment and opinion. Applications for reargument were also filed as amici curiae by the National Association of Water Companies—Pennsylvania Chapter, Pennsylvania Gas Association, Mechanicsburg Water Company, Philadelphia Suburban Water Company, T. W. Phillips Gas and Oil Company, Western Pennsylvania Water Company and Equitable Gas Company. All applications for reargument were denied February 18, 1981.

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1. The Supreme Court of Pennsylvania issued a consolidated opinion at No. 278 January Term, 1978 and No. 35 May Term, 1978, with the latter appeal involving a prior PG&W water rate increase. The facts and issues at No. 278 January Term, 1978, the subject of this Petition, were separate and distinct from those at No. 35 May Term, 1978. A separate Petition is being filed with this Court from No. 35 May Term, 1978.

2. PG&W is now a wholly-owned subsidiary of Pennsylvania Enterprises, Inc., which is a holding company with two groups of subsidiaries: one group includes PG&W and its five subsidiaries (Trucksville Water Company, Hillcrest Water Co., Homesite Water Company, Shavertown-Kingston Township Water Company and Penn Gas Development Co.) and the other group includes Pennsylvania Energy Resources, Inc. and Theta Land Corporation.

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No.

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PENNSYLVANIA GAS AND WATER COMPANY,
Petitioner,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Respondent.

[No. 278 January Term, 1978]

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF PENNSYLVANIA

Petitioner, Pennsylvania Gas and Water Company, respectfully prays that a writ of certiorari issue to review the judgment and opinion of the Supreme Court of Pennsylvania entered on February 1, 1980, in the case of *Pennsylvania Public Utility Commission v. Pennsylvania Gas and Water Company,* No. 278 January Term, 1978.[3]

3. See footnote 1, *supra.*

OPINIONS BELOW

The opinion of the Supreme Court of Pennsylvania (the "court below") is reported at — Pa. —, 424 A. 2d 1213 (1980) and together with concurring opinions appears as Appendix A hereto. Notice of denial of the applications for reargument appears as Appendix B. The opinion of the Commonwealth Court of Pennsylvania (Commonwealth Court) which was reversed by the court below is reported at 33 Pa. Commonwealth Ct. 143, 381 A. 2d 996 (1977) and appears as Appendix C. The order of the Pennsylvania Public Utility Commission which was reinstated by the court below was adopted July 7, 1976 at R. I. D. 209 and is not reported.

JURISDICTION

The opinion of the court below was entered on February 1, 1980, and its order denying reargument was entered on February 18, 1981. The jurisdiction of this Court is invoked under Title 28 of the United States Code § 1257(3).

CONSTITUTIONAL PROVISION INVOLVED

U. S. Constitution, Amendment XIV, Sec. 1:

> ". . . nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws."

STATEMENT OF THE CASE

PG&W is a Pennsylvania public utility corporation providing both water and gas services to the public in Northeastern Pennsylvania subject to regulation by the PUC, an administrative agency of the Commonwealth of Pennsylvania.

On January 17, 1975, PG&W filed with the PUC a proposed water rate increase providing for an increase in annual revenues of $2,643,212. The PUC permitted $1,321,606 of the increase to become effective on March 26, 1975, suspended the remaining $1,321,606 of the increase and instituted an investigation in respect to the entire increase at R. I. D. 209. In its final order dated July 7, 1976, the PUC disallowed the full amount of the rate increase under suspension.

PG&W petitioned the Commonwealth Court as of right for review of the PUC's order, contending that the rate base and rate of return findings were so low that the order was confiscatory. The Commonwealth Court by its order and opinion dated December 21, 1977 (Appendix C) reversed the PUC's July 7, 1976 order holding that its rate base finding constituted confiscation and a manifest abuse of discretion amounting to an error of law. The Commonwealth Court found no need to address PG&W's appeal as to the unconstitutionality of the rate of return finding since it found, as a matter of law, that the rate base was well in excess of the amount necessary to support the entire rate increase even under the PUC's rate of return finding. In respect thereto, the Commonwealth Court specifically stated:

> "In view of the foregoing, we need not consider PG&W's challenge to the PUC's finding as to fair rate of return." (Appendix C, p. A39).

Based thereon, the Commonwealth Court ordered the PUC to permit the entire rate increase to become effective.

On January 20, 1978, the PUC petitioned the court below for allowance of appeal from the Commonwealth Court's December 21, 1977 opinion. The petition which was allowed on June 21, 1978 did not address the rate of return issue but addressed the lawfulness of the Commonwealth Court's disposition of the rate base issue and the power of the Commonwealth Court to order the rates into effect. By judgment and opinion entered February 1, 1980 (Appendix A), the court below reversed the Commonwealth Court's December 21, 1977 opinion and reinstated the PUC's July 7, 1976 order. The court below failed, however, to remand the matter to the Commonwealth Court to address the constitutional challenge as to the rate of return finding which PG&W had timely raised and the Commonwealth Court had earlier found unnecessary to address. On February 14, 1980, PG&W filed with the court below an application for reargument contending:

> ". . . this Court overlooked the fact that PG&W's appeal on the fair rate of return finding had not been addressed by the lower court. Thus, the effect of the February 1, 1980 Opinion is that PG&W has been improperly denied its statutory and constitutional right of appellate review on the issue of fair rate of return. Although we believe there should be reargument on the entire proceeding, the least the Supreme Court should do is remand the matter to the Commonwealth Court with directions to address PG&W's appeal from the Commission's fair rate of return finding."

On February 18, 1981, the application for reargument was denied by the court below (Appendix B). The constitutional question was thus timely and properly raised by PG&W below.

REASONS FOR GRANTING THE WRIT

I. The Action of the Court Below in Denying PG&W Judicial Review Was a Deprivation of Due Process of Law

It has been firmly established by this Court that when a state administrative agency sets public utility rates, it is exercising a legislative power and as a consequence its findings are purely legislative in nature[4] and that confiscation of property in violation of the Fourteenth Amendment can result where a rate of return finding is unfairly low.[5] It is equally well established that the due process clause of the Fourteenth Amendment requires a state to submit constitutional questions to a judicial tribunal for review.[6]

When the Commonwealth Court found as a matter of law that the rate base was well in excess of the amount necessary to support PG&W's entire increase, it found no need to review the confiscatory rate of return issue (Appendix C, p. A39) and since that issue was not part of the appeal allowed from the Commonwealth Court decision, it was not before the court below for review. Following its reversal of the Commonwealth Court's decision, the court below, instead of remanding the matter to the Commonwealth Court to address the constitutionality of the rate of return finding, simply reinstated the PUC's

4. *Mayor and Aldermen of the City of Knoxville v. Knoxville Water Company*, 212 U. S. 1 (1909); *Prentis v. Atlantic Coast Line Company*, 211 U. S. 210 (1908).

5. *Federal Power Commission v. Hope Natural Gas Co.*, 320 U. S. 591 (1944).

6. *St. Joseph Stock Yards Co. v. United States*, 298 U. S. 38 (1936); *Oklahoma Operating Company v. Love*, 252 U. S. 331 (1920); *Ex parte Young*, 209 U. S. 123 (1908).

order (Appendix A, p. A16). PG&W applied for reargument expressly pointing out the denial of its statutory and constitutional right to judicial review of the confiscatory rate of return issue. Nevertheless, the court below again improperly failed to remand that issue and denied the application (Appendix B).

The court below's failure to remand to the Commonwealth Court has totally deprived PG&W of judicial consideration of a constitutional question involving a confiscatory finding by a legislative agency.[7] It represents a violation of the Fourteenth Amendment by a State through its courts, as this Court held in *Ohio Valley Water Company v. Ben Avon Borough*, 253 U. S. 287, 289 (1920):

> ". . . In all such cases, if the owner claims confiscation of his property will result, the state must provide a fair opportunity for submitting that issue to a judicial tribunal for determination upon its own independent judgment as to both law and facts; otherwise the order is void because in conflict with the due process clause, 14th Amendment. (Citations omitted)."[8]

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7. The PUC is an administrative agency of the Commonwealth of Pennsylvania created by the Pennsylvania legislature by Act of March 31, 1937 (Pa. P. L. 160, No. 143, 66 P. S. § 452, et seq.) (since repealed and replaced by similar provisions in the Pennsylvania Public Utility Code, Act of July 1, 1978, Pa. P. L. 598, No. 116, 66 Pa. C. S. § 301, et seq.).

8. Under analogous circumstances, this Court in *Dayton-Goose Creek Railway Company v. United States*, 263 U. S. 456, 485-486 (1924) held:

> "It is further objected that no opportunity is given under § 15a for a judicial hearing as to whether the return fixed is a fair return. The steps prescribed in the act constitute a direct and indirect legislative fixing of rates. No special provision need be made in the act for the judicial consideration of its reasonableness on the issue of confiscation. Resort to

The refusal of the court below to permit judicial review of a constitutional issue also represents a total denial of the separation of powers principle so fundamental to our American constitutional system and an abdication of the judicial duty to be ever watchful for constitutional rights and encroachments thereon.[9]

Through the action of the state court below, PG&W has been deprived of its constitutionally guaranteed due process right to judicial review and a writ of certiorari is needed to correct this violation.

II. The Action of the Court Below in Denying PG&W Judicial Review Was a Deprivation of Equal Protection of the Laws

Where there is a statutory right to judicial review, it is a deprivation of equal protection of the laws and hence a violation of the Fourteenth Amendment for a State through its courts to deprive a party of that right.[10]

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8. (Cont'd.)

the courts for such an inquiry exists under §§ 208 and 211 of the Judicial Code. It is only where such opportunity is withheld that a provision for legislative fixing of rates violates the Federal Constitution. (Citation omitted)"

It is significant to note that in the instant proceeding PG&W was deprived of a statutory right to judicial review. See part II hereof.

9. *O'Donoghue v. United States*, 289 U. S. 516 (1933); *Bustos-Ovalle v. Landon*, 225 F. 2d 878 (9th Cir. 1955); and *Jones v. Securities and Exchange Commission*, 298 U. S. 1 (1936).

10. See *Barbier v. Connolly*, 113 U. S. 27, 31 (1885), wherein this Court almost a century ago held:

"The 14th Amendment, in declaring that no State 'Shall deprive any person of life, liberty or property without due process of law, nor deny to any person within its jurisdiction the equal protection of the laws,' undoubtedly intended, not only that there should be no arbitrary deprivation of life or liberty or arbitrary spoliation of property but that equal pro-

When PG&W sought judicial review of the PUC's Order at R. I. D. 209, it did so as a matter of right pursuant to Section 1101 of the then effective Pennsylvania Public Utility Law (66 P. S. § 1431, repealed in part by Section 509(a)(115) of the Pennsylvania Appellate Court Jurisdiction Act of 1970 (17 P. S. § 211.101, et seq.), Act approved July 31, 1970, Pa. P. L. 673, No. 223, as amended (repealed)).[11] There was no discretion in the matter. The Commonwealth Court was required to review appeals from PUC Orders.

Through the action of the court below, PG&W has been deprived of its right to have the PUC's rate of return finding judicially reviewed, a deprivation made all the more serious because the finding in question, itself, involves the constitutional issue of confiscation in violation of the Fourteenth Amendment.

Since such a review is a matter of statutory right available to all Pennsylvania utilities similarly situated, the

10. (Cont'd.)

tection and security should be given to all under like circumstances in the enjoyment of their personal and civil rights; . . . that they should have like access to the courts of the country for the protection of their persons and property, the prevention and redress of wrongs, and the enforcement of contracts; that no impediment should be interposed to the pursuits of anyone except as applied to the same pursuits by others under like circumstances; that no greater burdens should be laid upon one than are laid upon others in the same calling and condition. . . ."

11. Although the Pennsylvania Public Utility Law has been replaced by the Pennsylvania Public Utility Code, Act of July 1, 1978, Pa. P. L. 598, No. 116 (66 Pa. C. S. § 101, et seq.) and the Pennsylvania Appellate Court Jurisdiction Act has been replaced by the Pennsylvania Judicial Code, Act of July 9, 1976, Pa. P. L. 586, No. 142, as amended (42 Pa. C. S. § 101, et seq.), Pennsylvania public utilities still have the statutory right to appeal decisions of the PUC to the Commonwealth Court.

action of the court below in refusing to remand the rate of return issue to the Commonwealth Court was a denial of the equal protection guarantee. See *Sexton v. Barry*, 233 F. 2d 220 (6th Cir. 1956), cert. den. 352 U. S. 870 (1956); *Republic Pictures Corporation v. Kappler*, 151 F. 2d 543 (8th Cir. 1945), aff'd 327 U. S. 757 (1946), reh. den. 327 U. S. 817 (1946). PG&W has been placed at a distinct disadvantage vis-a-vis other Pennsylvania utilities and a writ of certiorari is necessary to correct this constitutional violation.

CONCLUSION

For all of the foregoing reasons a writ of certiorari should issue to review the judgment and opinion of the Supreme Court of Pennsylvania.

Respectfully submitted,

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APPENDIX A.

IN THE
SUPREME COURT OF PENNSYLVANIA
MIDDLE DISTRICT AND EASTERN DISTRICT

No. 35 May Term, 1978

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellant

v.

PENNSYLVANIA GAS AND WATER COMPANY,
(WATER DIVISION),
Appellee

CITY OF SCRANTON, et al.

v.

PENNSYLVANIA GAS AND WATER COMPANY
(WATER DIVISION)

Appeal from Order of the Commonwealth Court of Pennsylvania, Dated May 27, 1975, at Nos. 1092, 1122, 1123 C.D. 1974, Reversing in Part of the Order of the Pennsylvania Public Utility Commission at R.I.D. 72, Dated July 9, 1974.

No. 278 January Term, 1978

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellant

v.

PENNSYLVANIA GAS AND WATER COMPANY—
WATER DIVISION
Appellee

OFFICE OF CONSUMER ADVOCATE
and
PENNSYLVANIA ATTORNEY GENERAL,
Intervenors

Appeal from the Order of the Commonwealth Court Dated December 21, 1977, at No. 1523 Commonwealth Docket 1976, Reversing the Order of the Pennsylvania Public Utility Commission at Rate Investigation Docket No. 209, Dated August 4, 1976.

Opinion

(Filed February 1, 1980)

NIX, *J.*

These two appeals present this Court with the troublesome issue of the correct standard to be employed by the Public Utility Commission (PUC) in fulfilling its legislative mandate to "ascertain and fix the fair value of the whole or any part of the property of any public utility." Act of May 28, 1937, P. L. 1053, art. III, § 311, 66 P. S. § 1151 (1958) [1] (the Act). For the reasons that follow, we are of the view that the PUC was correct in its determination and that its orders should not have been disturbed. Accordingly, we reverse the orders of the Commonwealth Court below.

The complex facts surrounding these appeals are fully set forth in the opinions of the Commonwealth Court.[2] For our purposes, the following brief factual reci-

(1) This Act was repealed by the Public Utility Code of 1978, 66 Pa. C. S. A. §§ 1 *et seq.*, effective August 29, 1978. The instant appeals are concerned solely with the 1937 Act.

(2) The opinion of the Commonwealth Court in No. 35 May Term 1978 (PG&W I) is set forth at 19 Pa. Commw. Ct. 214, 341

tation is sufficient. The appeal at No. 35 May Term 1978 (PG&W I) concerns construction and improvement projects undertaken by the Pennsylvania Department of Highways that were anticipated to affect the water supply of the Pennsylvania Gas & Water Company (PG&W) within its Roaring Brook watershed area. An agreement was entered into between the Department and PG&W to remedy and minimize the adverse effect of this federally funded highway project on the turbidity and purity of the water derived from the watershed. This agreement provided that the Department would contribute to PG&W a sum in excess of $2.7 million toward the construction of a new dam, reservoir, and a 30-inch pipeline. The PUC rejected the attempt by PG&W to include this $2.7 million payment in its base for accounting and rate making purposes.[3] The Commonwealth Court reversed the PUC on the ground that the exclusion of the $2.7 million payment from the rate base constituted a violation of the principles enunciated in *Keystone Water Co. v. PUC*, 19 Pa. Commw. Ct. 292, 339 A. 2d 873 (1975), affirmed by an equally divided Court, 477 Pa. 594, 385 A. 2d 946 (1978). We granted the PUC's petition for allocatur.

The appeal at No. 278 January Term 1978 (PG&W II) concerns PG&W's request for a two-step increase in its rates. The PUC approved the first step, but disallowed the second step after ascertaining and fixing PG&W's rate base at $87,700,000 and allowing it a return of 8.53 per cent. The Commonwealth Court reversed the PUC, find-

2. (Cont'd.)
A. 2d 239 (1975). The opinion of that court in No. 278 January Term 1978 (PG&W II) is found at 33 Pa. Commw. Ct. 143, 381 A. 2d 996 (1977).

(3) By including this payment into its base, PG&W could pass this windfall on to its stockholders and *also* request higher rates from the public in order to compensate for the injury to its watershed.

ing that the PUC's determination of the fair value of PG&W's rate base was legally incorrect in view of its earlier opinions in the *PG&W I* and *Keystone*. We granted the PUC's petition for review and the petitions to intervene filed by the Attorney General and the Office of Consumer Advocate, and ordered the matters to be argued together.

1. The Appeal at No. 35 May Term, 1978

Before we discuss the legal and historical basis surrounding the "fair value" controversy, we think it proper to set forth the rationale employed by the PUC in support of its Order rejecting PG&W's attempt to include the state's $2.7 million payment in its base for accounting and rate making purposes:

> For public utility accounting and rate making purposes we must reject respondent's contention. Property, which is used or useful in rendering a public utility service and which has been a part of a public utility's rate base is dedicated to a public use, and is impressed with a public trust. It (or the proceeds or accruals therefrom) is subject to regulation by the properly designated regulatory body and remains subject to that regulation until such time as that regulatory body duly finds it in the public interest to approve its release from public service. Such property must be regulated in the interest of the public no less than in the interest of the utility. Equities must be balanced and justice must be done to all concerned. Accordingly, when a utility suffers extraordinary losses in service value of utility property abandoned or otherwise retired from service, or suffers unforeseen damages to property which damages could not reasonably be anticipated, and where the utility has not otherwise recovered its investment,

this Commission can and, where equities require, does permit the utility to recover from the ratepayers, as a proper and necessary expense of rendering the public service, the necessary amount to make the utility whole. On the other hand, where, as here, the utility recovers an amount or sum as a result of compensation for particular property and the potential consequential injury to the service of the ratepayers for whom that property was dedicated to the public use, the Commission, where the equities dictate, may require that amount received by the utility to be treated, for public utility accounting and rate making purposes, in such manner as will place the utility and the ratepayers in the same position, insofar as reasonably possible, as they were before the extraordinary event or transaction which gave rise to the sum or amount in question.

For rate making purposes, we cannot permit respondent to receive all the salutary effects of the agreement and pass them on to the stockholders as a windfall while passing on to the ratepayers only the increased rates that would become necessary had there been no agreement and contribution. Clearly, the payment in question resulted and stemmed from consideration of the property's dedication to public use as a water utility, and recognition of the potential injury to the interests and service of the water utility customers. In situations and circumstances such as this, the customers of a utility are in the nature of third party beneficiaries whose interest in the utility service must be protected. The essence of public utility regulation is the protection of the public and the assurance of adequate service to them at reasonable rates on the one hand, and, on the other, a fair opportunity to the utility to secure a reasonable rate

and no windfall from such services. To reflect equitably and meaningfully the near restoration of, or equitable substitution for, the pre-agreement status quo, both the utility and its customers must be made whole insofar as reasonably possible.

First, the majority opinions of the Commonwealth Court in *Keystone* and in the instant case reflect a misperception of the regulatory authority of the Commonwealth and its chosen instrumentality for carrying out the desired objectives (the Pa. PUC) and the significance of the notion of deference which accompanies that regulatory scheme. The PUC's functions in valuing utility property [4] and in fixing just and reasonable rates of return thereon [5] are exercises of the regulatory powers of the Common-

(4) *Valuation of property of a public utility*

The commission may, after reasonable notice and hearing, ascertain and fix the fair value of the whole or any part of the property of any public utility, in so far as the same is material to the exercise of the jurisdiction of the commission, and may make revaluations from time to time and ascertain the fair value of all new construction, extensions, and additions to the property of any public utility. When any public utility furnishes more than one of the different types of utility service enumerated in paragraph seventeen of section two of this act [66 P. S. § 1102(17)], the commission shall segregate the property used and useful in furnishing each type of such service, and shall not consider the propery of such public utility as a unit in determining the value of the property of such public utility for the purpose of fixing rates.

Public Utilities Law, § 311, 66 P. S. § 1151.

(5) *Rates to be just and reasonable*

Every rate made, demanded, or received by any public utility, or by any two or more public utilities jointly, shall be just and reasonable and in conformity with regulations or orders of the commission.

Id. at § 301, as amended, 66 P. S. § 1141.

wealth. *Cf., Nebbia v. New York,* 291 U. S. 502 (1934). Regulation amounts to a taking when government forces "some people alone to bear public burdens, which, in all fairness and justice, should be borne by the public as a whole." *Armstrong v. U. S.,* 364 U. S. 40, 49 (1960). Accordingly, it must be determined whether the PUC's exclusion from PG&W's rate base of a payment made out of public funds to construct a reservoir and pipeline to minimize the effects of a public construction project on the performance of water supply functions which are public in nature, forced PG&W's investors and shareholders alone to bear public burdens which in fairness and justice should have been borne by the utility's rate payers as a whole.

The second deep-rooted fallacy in the Commonwealth Court analysis in this area has to do with confusing valuation for eminent domain purposes with valuation for regulatory purposes. These various processes of valuation are no more necessarily interrelated or interdependent than valuation for real property assessment purposes or any other circumstances in which the law requires valuation of property for the performance of a discrete and separate governmental function. *See generally* Bonbright, Valuation of Property (1937). The mere fact that a particular part of the company's property was valued at its cost of reproduction in an eminent domain award is not dispositive nor controlling as to its proper valuation for regulatory purposes. The purpose of just compensation in eminent domain is to put the owner "in as good a position pecuniarily as it would have occupied, if its property had not been taken." *U. S. v. New River Collieries,* 262 U. S. 341 (1923). But it has been cogently observed that "the purpose of regulating utility rates, unlike that of condemning property, is to correct an economic maladjustment whereby the company owning the property is ad-

judged to have an undue advantage over the rest of the community." Hale, Freedom Through Law—Public Control of Private Governing Power, p. 463.

In the case of water companies, the advantages which they have secured over the rest of the community have stemmed directly from their status as public corporations. *White v. City of Meadville*, 177 Pa. 643, 35 A. 695 (1896). For example, at various times, water companies have been vested with eminent domain taking powers which gave them the right to take streams [6] and to acquire land to preserve their water supply from contamination.[7] So, too, such rights as any water company enjoys to divert water for the purpose of supplying municipalities or other consumers are, because they exceed the common law rights of the riparian owner, wholly public in that they arise by virtue of public eminent domain and regulatory powers. *Lord v. Meadville Water Co.*, 135 Pa. 122, 19 A. 1007 (1890); *Haupt's Appeal*, 125 Pa. 211, 17 A. 436 (1889).

In refusing to include the $2.7 million contribution made by the Commonwealth toward the capital construction costs of the reservoir and pipeline necessitated by the anticipated impact of the federally aided highway construction project in PG&W's rate base, the PUC in effect disallowed PG&W an addition to the original cost measure upon which the property in question was valued. In so doing, PG&W contends that the PUC contravened the controlling statutory norm requiring it "to ascertain and fix the *fair value* of the whole or any part of the property of any public utility." Public Utility Law, § 311, 66 P. S. § 1151 (emphasis supplied). PG&W further contends that this statutory norm of "fair value" either incorporates by

(6) Corporation Act of 1874, Act of April 29, 1874, P. L. 73, No. 32, § 34 as amended by the Act of May 16, 1889, P. L. 226, No. 232.

(7) Act of May 26, 1893, P. L. 158, No. 103.

reference the meaning of that term as adumbrated in *Smyth v. Ames*[8] or, in the alternative, is bottomed on the continuing validity of *Smyth* as a standard for adjudicating the constitutionality of rate regulation under the Federal Constitution.

In construing the statutory norm of fair valuation, we must, of course, view that standard within the context of the enactment as a whole. Accordingly, we find that the overriding principle governing the PUC's performance of its duty is to determine "just and reasonable" rates pursuant to Public Utility Law § 301, 66 P. S. § 1141. *New York Telephone and Telegraph v. PSC*, 309 N. Y. 569, 579-580, 132 NE. 2d 847, 850-51 (1956). Thus, the "fair value" must reflect rates that are "just and reasonable." The rate making function consists of a two-step process to effectuate the paramount responsibility of fix-

(8) 169 U. S. 466 (1898). The holding in *Smyth* reads as follows:

> We hold . . . that the basis of all calculations as to the reasonableness of rates to be charged by a corporation maintaining a highway under legislative sanction must be the fair value of the property being used by it for the convenience of the public. And in order to ascertain that value, the original cost of construction; the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case. We do not say that there may not be other matters to be regarded in estimating the value of the property. What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience. On the other hand, what the public is entitled to demand is that no more be exacted from it for the use of a public highway than the services rendered by it are reasonably worth. *Id.* at 546.

ing "just and reasonable" rates: fair valuation of utility property and the ascertainment of a reasonable rate thereon. There is ample authority for the proposition that the power to fix "just and reasonable" rates imports a flexibility in the exercise of a complicated regulatory function by a specialized decision-making body and that the term "just and reasonable" was not intended to confine the ambit of regulatory discretion to an absolute or mathematical formulation but rather to confer upon the regulatory body the power to make and apply policy concerning the appropriate balance between prices charged to utility customers and returns on capital to utility investors consonant with constitutional protections applicable to both. *See Utah Power and Light Co. v. PSC*, 107 Utah 155, 190-191, 152 P. 2d 542, 558 (1944). *Accord, State v. N. J. Bell Telephone Co.*, 30 NJ 16, 152 A. 2d 35 (1959).

The opinion in support of affirmance in *Keystone* did not deny the primacy of the "just and reasonable" standard or that it represented a delegation of policy-making powers to the PUC which are basically legislative in nature. That opinion, however, accepted the notion that the term "fair value" was intended to have a fixed meaning incorporating by reference the rule in *Smyth v. Ames*, as interpreted in *Bluefield Water Works v. Public Service Commission*,[9] with respect to the weight of reproduction cost data in rate making. *Keystone*, 477 Pa. at 607-08, 385 A.2d at 953-54.

The legislative history of public utility regulation in this Commonwealth does not support this assertion. The 1913 Public Service Company Law which is the grandfather of the present statute spelled out the meaning of "fair value" by express incorporation of each factor enumerated in *Smyth v. Ames*. Act of July 16, 1913, P. L. 1734, No. 854, art. V, § 20. The purpose of such enumera-

(9) 262 U. S. 679 (1923).

tion was to draft a constitionally valid statute by including therein almost *in ipsis verbis* the constitutional rule concerning rate fixing powers as it was understood at the time that the statute was drafted. *See* Munson, The Public Service Company Law (1914). The 1937 statute superseding the 1913 law significantly omitted any definition or specification of the meaning of "fair value." The Superior Court considered that this omission was consistent with a legislative intent to define "fair value" as synonymous with that concept as expressly defined by the prior statute and in *Smith v. Ames. Solar Electric Co. v. PUC*, 137 Pa. Super. 325, 326, 9 A. 2d 447 (1939). However, this omission is equally consistent with a legislative intent to free itself from the shackles of express adherence to an understanding of the constitutional meaning of "fair value" which was in evolution at the time that the 1937 statute was drafted. *See* Rose, *The Hope Case and Public Utility Valuation*, 54 Col. L. Rev. 188, 195 (1954); Bauer & Gold, Public Utility Valuation for Purposes of Rate Control, p. 155 *et seq.* (1935).

In any event, even assuming *arguendo* that the legislature intended to acquiesce in the "fair value" principle as enunciated in *Smyth v. Ames*, little comfort is thereby afforded to PG&W. The rule in *Smyth v. Ames* fixes the very broad constitutional boundaries within which the legislature may exercise or infer discretionary leeway in rate-making. As a leading commentator observed:

> It is obvious that the instruction that is the essence of 'fair value'—to give the matters for consideration (principally original cost and reproduction cost) such weight as may be just and right—is not operational. It offers no criterion or rule to determine what is 'just and right' and, therefore, does not provide a method to ascertain a uniquely determinate value of the weight to be assigned to each of the 'matters for con-

> sideration' in a finding of fair value. . . . The fact is that *fair value is an indeterminate magnitude lying anywhere between original cost and reproduction cost.* [Emphasis added].
>
> Rose, *Confusion in Valuation for Public Utility Rate Making*, 47 Minn. L. Rev. 1, 23 (1962).

Properly understood, *Smyth v. Ames* speaks only to the outer boundaries beyond which, on the one hand, a regulator approaches an uncompensated eminent domain taking of investor property by valuing it below its original cost and, on the other hand, a regulator approaches an unlawful taxation of consumers under the guise of rate fixing by valuing the property in excess of its reproduction cost. Between these extremes, the question is one of policy for the regulatory body concerning which the judicial branch is not warranted in interposing economic theories. Unless the PUC's decision does not bear a real and substantial relationship to the regulatory objects sought to be obtained by it, that judgment must prevail. *Gambone v. Commonwealth*, 375 Pa. 547, 101 A. 2d 634 (1954); *Pennsylvania State Bd. of Pharmacy v. Pastor*, 441 Pa. 186, 272 A. 2d 487 (1971).

Thus, "fair value" as understood in *Smyth v. Ames* does not compel reversal of the PUC's determination either as a matter of statutory or constitutional law. In the instant case, the PUC duly considered the evidence proffered by PG&W as to the reproduction cost of the watershed properties but concluded that, under the circumstances of the particular case, the allowance of any addition to original cost figures for rate making purposes was not just and reasonable and that the 2.7 million dollar payment should be more appropriately treated as a "contribution," as it was designated by the agreement between PG&W and the Department of Highways, rather than as

an additional investment of capital. As we observed in an earlier case:

> The ascertainment of the fair value of the property, for rate making purposes, is not a matter of formulas, but is a matter which calls for the exercise of a sound and reasonable judgment upon a proper consideration of all relevant facts. The commission is not bound to adopt any one method to the exclusion of all others. It may take into consideration various methods, and use its judgment as to the extent to which they shall be employed. The original cost of the property is not to be taken as controlling, for there may have been extravagance in purchasing, or bad management; and, on the other hand, there may have been an actual increase in values since the original purchase or construction. Then again the reproduction cost, less depreciation, may not give the present fair value of an old property, for it may not now be desirable to reproduce the old type of plant. Improved machinery, and better methods of operation, may have come into vogue, which would make it true economy to relegate much of the physical structure of an old plant to the scrap heap. Much must be left to the sound discretion of the appraising body, the tribunal appointed by law and informed by experience, for the discharge of these delicate and complex duties. Its report must, of course, justify itself in reason, upon review in the appellate courts.
>
> *Ben Avon Boro v. Ohio Valley Water Co.*, 260 Pa. 289 at 308-309, 103 A. 744 (1918).

The error which the Commonwealth Court and the opinion in affirmance in *Keystone* fell into was the assumption of a constitutionally mandated nexus between the "fair value" standard and cost of reproduction figures. The

unsoundness of this assumption is manifested in the fact that this Court denies that reproduction cost figures have any probative value for real property tax assessment purposes because of their hypothetical and speculative nature. *Buhl Foundation v. Bd. of Property Assessment*, 407 Pa. 567, 180 A. 2d 900 (1962); *U. S. Steel Corp. v. Bd. of Assessment & Rev. of Taxes*, 422 Pa. 463, 223 A. 2d 92 (1966). Reproduction cost figures are clearly admissible in PUC proceedings but we see nothing in the "fair value" rule that requires, either as a statutory or constitutional mandate, that they *must be accepted* in whole or in part for valuation purposes. We, therefore, repudiate any intimations in these decisions or in prior case law that has the effect of suggesting a constitutional mandate requiring the inclusion of reproduction cost figures in arriving at the appropriate rate structure in public utility valuation cases.

To follow the Commonwealth Court and the opinion in affirmance in *Keystone* down the path of attempting to apply a constitutional taking analysis to valuations of property by the PUC which do not go beyond original cost, is unsound both in principal and as a matter of judicial policy.

In the former respect, it commits the judicial branch to a constitutionally grounded review of all rate requests in which the PUC has on an item by item basis failed to go beyond original cost valuation. In the case at bar, PG&W sought to include a replacement cost figure *in toto* in the rate base because of the fortuity that the property in question was subject to taking for eminent domain purposes. But if PG&W's entitlement is constitutionally founded, then it must be accorded revaluation at reproduction cost as to every item on its property concerning which it requests revaluation since the maturing of its constitutional rights cannot turn on the mere happenstance of a public taking. It is no answer to say that the

PUC's accounting rules do not permit such a result since the accounting rules as creatures of statute cannot prevail against a constitutionally grounded right.

In the latter respect, the opinions commit us without either statutory or constitutional warrant to a slippery slope of judicial intervention into rate making whose limit we cannot now foresee. We can, call upon the experience of the United States Supreme Court with respect to judicial intervention in these matters as a guide. As Justice Stone warned in his dissenting opinion in *West v. Chesapeake & Potomac Telephone Co.*, 295 U. S. 662, 689 (1935), "In assuming the task of determining judicially the present fair replacement value of the vast properties of public utilities, courts have been projected into the most speculative undertaking imposed upon them in the entire history of English jurisprudence." It is a task which this Court refused to undertake in *Ben Avon Boro, supra* and the wisdom of that judgment was ultimately recognized by the United States Supreme Court in *FPC v. Natural Gas Pipeline Co.*, 315 U. S. 575, 586 (1942) (the Constitution does not bind rate making bodies to the service of any single formula or combination of formulas). Thus in *Natural Gas Pipeline* that Court limited its scope of review, "if the Commission's order, as applied to the facts before it and viewed in its entirety, produces no arbitrary result, our inquiry is at an end." *Id.*

A careful examination of the record in this case has led us to the conclusion that in the items wherein the Commonwealth Court differed from the PUC upon the questions presented to it, there was merely the substitution of the court's judgment for that of the Commission, rather than a determination that the order of the latter was unlawful.

Accordingly, we reverse the order of the Commonwealth Court below, and reinstate the order of the Public Utility Commission.

2. The Appeal at No. 278 January Term, 1978

As the preceding discussion has totally undercut the legal foundation for the Commonwealth Court's decision in this case, we reverse that court's order entered below. Based on our analysis of the arguments presented to this Court on the merits of the rate increase, we find that the order of the PUC is supported in law and by sufficient facts. Accordingly, we reinstate the order of the PUC entered below.

The orders of the Commonwealth Court are reversed and the orders of the Public Utility Commission are reinstated.

Justice Manderino did not participate in the decision of this case.

Mr. Justice Roberts joins the majority and filed a concurring opinion.

Mr. Justice Larsen joins the majority and filed a concurring opinion.

SUPREME COURT OF PENNSYLVANIA
MIDDLE DISTRICT

No. 35 May Term, 1978

PENNSYLVANIA PUBLIC UTILITY COMMISSION

v.

PENNSYLVANIA GAS AND WATER COMPANY
CITY OF SCRANTON, et al

v.

PENNSYLVANIA GAS AND WATER COMPANY

APPEAL OF: PENNSYLVANIA PUBLIC UTILITY COMMISSION

Judgment

ON CONSIDERATION WHEREOF, it is now here ordered and adjudged by this Court that the orders of the Commonwealth Court of Pennsylvania are reversed and the orders of the Public Utility Commission are reinstated.

/s/ MILDRED E. WILLIAMSON
Deputy Prothonotary

Dated: February 1, 1980

IN THE
SUPREME COURT OF PENNSYLVANIA
MIDDLE DISTRICT

No. 35 MAY TERM, 1978

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellant

v.

PENNSYLVANIA GAS AND WATER COMPANY
(WATER DIVISION)

CITY OF SCRANTON ET AL.

v.

PENNSYLVANIA GAS AND WATER COMPANY
(WATER DIVISION)

Appeal from order of the Commonwealth Court of Pennsylvania, dated May 27, 1975, at Nos. 1092, 1122, & 1123 C. D. 1974, Reversing in part the order of the Pennsylvania Public Utility Commission at R. I. D. 72, dated July 9, 1974.

IN THE
SUPREME COURT OF PENNSYLVANIA
EASTERN DISTRICT

No. 278 January Term, 1978

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellant

v.

PENNSYLVANIA GAS AND WATER COMPANY
(WATER DIVISION)

OFFICE OF CONSUMER ADVOCATE and
PENNSYLVANIA ATTORNEY GENERAL,
Intervenors

Appeal from order of the Commonwealth Court of Pennsylvania, dated December 21, 1977, at No. 1523 C. D. 1976, Reversing the order of the Pennsylvania Public Utility Commission at R. I. D. 209, dated August 4, 1976.

Concurring Opinion
Filed February 1, 1980

ROBERTS, *J.*

The PUC is statutorily and constitutionally obliged to set "just and reasonable" rates and may, but is not required to, use cost of reproduction in the rate base. See *Keystone Water Co. v. Pennsylvania Public Utility Commission*, 477 Pa. 594, 615-26, 385 A. 2d 946, 957-63 (1978) (Opinion of Roberts, J., in Support of Reversal, joined by Eagen, C.J. & Nix, J.). I join the majority opinion which is in accord with the views expressed in the Opinion in Support of Reversal in *Keystone Water*, and I agree with the majority that the orders of the Commonwealth Court should be reversed and the orders of the PUC reinstated.

IN THE
SUPREME COURT OF PENNSYLVANIA
MIDDLE DISTRICT AND EASTERN DISTRICT

No. 35 MAY TERM, 1978

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellant

v.

PENNSYLVANIA GAS AND WATER COMPANY,
(WATER DIVISION),
Appellee

CITY OF SCRANTON, et al.

v.

PENNSYLVANIA GAS AND WATER COMPANY
(WATER DIVISION)

Appeal from Order of the Commonwealth Court of Pennsylvania, Dated May 27, 1975, at Nos. 1092, 1122, 1123 C. D. 1974, Reversing in Part of the Order of the Pennsylvania Public Utility Commission at R. I. D. 72, Dated July 9, 1974.

No. 278 JANUARY TERM, 1978

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellant

v.

PENNSYLVANIA GAS AND WATER COMPANY—
WATER DIVISION,
Appellee

OFFICE OF CONSUMER ADVOCATE

and

PENNSYLVANIA ATTORNEY GENERAL,

Intervenors

Appeal from the Order of the Commonwealth Court Dated December 21, 1977 at No. 1523 Commonwealth Docket 1976 Reversing the Order of the Pennsylvania Public Utility Commission at Rate Investigation Docket No. 209, Dated August 4, 1976.

Concurring Opinion

Filed February 1, 1980

JUSTICE ROLF LARSEN

I join in the majority opinion. Additionally, I would add that under no circumstances can a "windfall" or gift to a utility be included in a rate base.

APPENDIX B.

[Letterhead of]

SUPREME COURT OF PENNSYLVANIA

EASTERN DISTRICT

Carl Rice, Esq.
Prothonotary
Catherine E. Lyden
Deputy Prothonotary

456 City Hall
Philadelphia, 19107
(215) 686-3581-84

February 19, 1981

Charles E. Thomas, Esquire
212 Locust Street
P.O. Box 999
Harrisburg, PA 17108

Re: Pa. Public Utility Commission, Applt. v.
Pa. Gas and Water Company—Water Div.
No. 278 January Term, 1978

Dear Mr. Thomas:

This is to advise you that the following Orders have been entered in the above-captioned matter.

On Application of Pennsylvania Gas and Water Company for Reargument:

"February 18, 1981.

Application for Reargument DENIED.
Per Curiam."

On Application of National Association of Water Companies, et al., for Leave to File Application for Reargument as Amici Curiae and Application for Reargument:

"February 18, 1981.

Application for Reargument DENIED.

Per Curiam."

Very truly yours,

CARL RICE
Carl Rice, Esq.
Prothonotary

CR/fm

cc: Joseph J. Malatesta, Jr., Esquire
Gerald Gornish, Esquire
Mark P. Widoff, Esquire
Alan R. Reed, Esquire
West Publishing Company

[*Note:* The Prothontary has advised that the Applications for Reargument were denied on February 18, 1981 and that the denial was endorsed by the court below upon the cover of the application, but no order was issued.]

APPENDIX C.

IN THE
COMMONWEALTH COURT OF PENNSYLVANIA

No. 1523 C. D. 1976

PENNSYLVANIA GAS AND WATER COMPANY—
WATER DIVISION,
Petitioner

v.

COMMONWEALTH OF PENNSYLVANIA,
PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Respondent

Before: HONORABLE JAMES S. BOWMAN, President Judge
HONORABLE JAMES C. CRUMLISH, JR., Judge
HONORABLE HARRY A. KRAMER, Judge
HONORABLE ROY WILKINSON, JR., Judge
HONORABLE GLENN E. MENCER, Judge
HONORABLE THEODORE O. ROGERS, Judge
HONORABLE GENEVIEVE BLATT, Judge

Argued: June 7, 1977

Opinion by President Judge Bowman
Filed December 21, 1977

This case is before us upon a petition for review filed by the Pennsylvania Gas and Water Company (PG&W) which challenges an order, dated July 7, 1976, issued by the Pennsylvania Public Utility Commission (PUC).

PG&W is a combination public utility rendering both natural gas and water service.[1] At the end of the test year, September 30, 1974, it provided water service to 128,401 customers representing 144,559 consumer units.[2] Its service area covers a 165 square-mile area in Northeastern Pennsylvania and includes 60 municipalities. This service area is divided into two divisions, viz, Spring Brook Division and Scranton Division, which are not physically interconnected for the exchange of any appreciable volume of water. Over 60 reservoirs and 1600 miles of water mains make up its distribution system.

On January 17, 1975, PG&W filed Supplements No. 22 and No. 23 to Tariff Water—Pa. P. U. C. No. 3 (Spring Brook Division) and Supplements No. 23 and No. 24 to Tariff Water—Pa. P. U. C. No. 4 (Scranton Division), proposing increases in all existing rates to become effective March 18, 1975. The proposed increases were calculated to produce $2,643,212 in additional annual revenues, exclusive of the State Tax Adjustment Surcharge. This amount would constitute approximately a 20% increase in revenues, with each of two steps in the supplements providing a 10% increase as follows:

---

1. PG&W is a wholly owned subsidiary of Pennsylvania Enterprises, Inc. (PEI), a newly formed holding company having common stock publicly traded on a major stock exchange. PEI, which currently has no other utility operating subsidiaries, was formed for purposes of diversification into nonutility endeavors. PEI's nonutility subsidiary companies are Pennsylvania Energy Resources, Inc. (PERI), a recently formed diversified service and energy resource company, and Theta Land Corporation, a newly formed land development and sales company. Petitioner, PG&W, continues to issue debt and preferred stock publicly under its own name.

2. The distinction between customers and consumer units lies in the fact that the former are parties who are billed for service while the latter are families or individuals receiving service.

First Step

Supp. No. 22 to Tariff No. 3 (Spring Brook) .	$ 769,262
Supp. No. 23 to Tariff No. 4 (Scranton)	552,344
	$1,321,606

Second Step

Supp. No. 23 to Tariff No. 3 (Spring Brook) .	$ 769,262
Supp. No. 24 to Tariff No. 4 (Scranton)	552,344
	$1,321,606

As noted earlier, these supplements were based on a test year ended September 30, 1974, and they totaled $2,643,212. The proposed effective date was voluntarily postponed to March 26, 1975. Supplement No. 22 to Tariff No. 3 and Supplement No. 23 to Tariff No. 4 were not suspended by the PUC and became effective by operation of law on March 26, 1975. By PUC order dated March 25, 1975, docketed at R. I. D. No. 209, Supplements No. 23 to Tariff No. 3 and No. 24 to Tariff No. 4 were suspended to September 26, 1975. By an order dated September 23, 1975, the suspension was extended to December 26, 1975. PG&W voluntarily extended the suspension to January 1, 1976. On December 30, 1975, the PUC set existing rates as temporary rates for a period of 60 days. Through several extensions the temporary rates remained in effect until July 8, 1976. As a result of the PUC's investigation of the reasonableness and lawfulness of the supplements filed by PG&W, including four days of hearings held during July and September of 1975,[3] the

3. Six formal complaints filed in opposition to the rate increase were consolidated with the Commission investigation for the purpose of hearing and determination. None of these complainants participated to any significant extent at the hearings.

PUC, by a 3 to 2 vote issued an order, dated July 7, 1976, which disallowed the entire $1,321,606 second step of the proposed rate increase. It is noteworthy that only PG&W presented any evidence at the hearings. Counsel for the PUC limited his participation to cross-examination of PG&W's witnesses.

In its adjudication, the PUC found a fair value of $87,700,000 and a fair rate of return of 8.53 percent, thus providing income available for return in the amount of $7,482,668. This return, together with the PUC's findings on operating expenses, depreciation, taxes, and other adjustments set forth in the adjudication, led the PUC to conclude that the allowable annual revenues were $14,574,017. This figure is precisely $1,321,606 less than the total revenues sought by PG&W in its filings and results in the precise disallowance of the second step of the proposed increase. A timely petition for review by PG&W brings the PUC's determination before us.

PG&W asserts that the PUC's disallowance of the second step of the proposed increase and its findings as to fair value and fair rate of return are arbitrary, capricious, unreasonable and contrary to law and amount to an unconstitutional confiscation of PG&W's property. Our scope of review in PUC cases is limited to a determination of whether constitutional rights have been violated, an error of law committed, or if there is a lack of substantial evidence to support the findings, determination, or order of the PUC.[4]

4. The appellate scope of review in PUC cases was formerly found under Section 1107 of the Public Utility Law, Act of May 28, 1937, P. L. 1053, *as amended*, 66 P. S. § 1437. The scope of review provisions of that section were repealed by the Act of October 7, 1976, P. L. 1057, § 20. Prior to its repeal, however, Section 1107 was suspended by Pa. R. A. P. 5105(c), while Pa. R. A. P. 1551(b) simultaneously adopted, in our view, the scope of

We may start with the basic proposition that, in the establishment of just and reasonable utility rates under the Public Utility Law (Act), Act of May 28, 1937, P. L. 1053, *as amended*, 66 P. S. § 1101 et seq., the utility must be allowed a fair return on the fair value of its property devoted to the service of the public. *Keystone Water Co. v. Pennsylvania Public Utility Commission*, 19 Pa. Commonwealth Ct. 292, 301, 339 A. 2d 873, 877 (1975). The establishment of rates which provide less than a fair return on the fair value of such property results in a confiscation of the utility's property in violation of the Fifth and Fourteenth Amendments to the United States Constitution and Article I, Sections 9 and 10 of the Pennsylvania Constitution. *Keystone, supra.*

Turning first to a consideration of the PUC's finding of the fair value of PG&W's property, we must agree with PG&W that the finding reflects arbitrary and capricious action on the part of the PUC and a manifest abuse of its discretion. As noted earlier, PG&W was the only party to present any evidence at the proceedings before the PUC. PG&W presented evidence that its total net original cost (original cost depreciated) for both divisions amounted to $72,054,977. PG&W presented evidence that its trended original cost depreciated[5] at five-year average prices was $198,098,094.[6] Based on the average of these

4. (Cont'd.)
review as it existed under Section 1107 and the case law. *See, e.g., Johnstown-Pittsburgh Express, Inc. v. Public Utility Commission*, 5 Pa. Commonwealth Ct. 521, 291 A. 2d 545 (1972).

5. Trended original cost depreciated provides a value approximately equivalent to reproduction cost depreciated and constitutes an acceptable substitute for average price reproduction costs. *Pittsburgh v. Pennsylvania Public Utility Commission*, 187 Pa. Superior Ct. 341, 349 n. 5, 144 A. 2d 648, 653 n. 5 (1958).

6. PG&W also presented evidence that its trended original cost at three-year average prices was $210,406,882. However, only the

measures of value at original cost depreciated and trended original cost at five-year average prices, PG&W contended that the fair value of its plant should be $135,076,535. After criticizing some of the price indices and methodology used by PG&W in its trending, the PUC, without making any formal or specific adjustments to any of PG&W's original or trended cost figures, set a fair value at $87,700,000.

At the outset, we note that the PUC's failure to make any specific adjustments to PG&W's cost figures affords us no insight into the precise weight given the various cost elements by the PUC in arriving at fair value. Although this does not frustrate our review in the circumstances of the present case, it does make our task most difficult and we once again admonish the PUC to disclose in some detail in its adjudications the figures upon which its conclusions are based and the methods employed in arriving at those conclusions.

The law governing fair value determinations by the PUC was aptly summarized by this Court in the last rate case before us involving PG&W, *Pennsylvania Public Utility Commission v. Pennsylvania Gas and Water Co.*, (*PG&W I*), 19 Pa. Commonwealth Ct. 214, 341 A. 2d 239 (1975). Writing for the Court, Judge Kramer stated:

> "The fair value figure represents a judgment to be made by the PUC within its discretion, and there is no magical mathematical formula to which the PUC is bound in determining fair value. . . . The PUC must consider all relevant elements and factors having a bearing on fair value, including original cost and trended original cost. . . . In Pittsburgh v. Pennsylvania Public Utility Commission, 171 Pa. Superior Ct. 187, 195, 90 A. 2d 607, 612 (1952), our Superior Court stated:

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6. (Cont'd.)
five-year figure was used by PG&W to calculate the fair value figure submitted to the PUC by PG&W.

> " 'The weight to be given any particular measure of value, such as original cost or reproduction cost [trended original cost], is for the Commission, but its action must be within the area of its administrative discretion and supported by the evidence.' "

PG&W I, supra at 228, 341 A. 2d at 248 (citations omitted).

Judge Kramer went on to note:

> "From our reading of the Act, we are certain only that the sole use of original cost statistics or the sole use of reproduction costs statistics would violate the legislative intent. We have no doubt that the Legislature intended an averaging process somewhere between the two extremes, and, so long as the fair value set by the PUC is not below or above those two extremes, or arbitrarily set so close to either extreme that we can discern a capricious disregard of the evidence or the law, we will not interfere." *Id.* at 230, 341 A. 2d at 249.

In *PG&W I*, we held that a fair value which was approximately 150 percent of the net original cost as found by the PUC could not be said to be an abuse of discretion per se. In the present case, the fair value set by the PUC is approximately 121 percent of the net original cost figure submitted by PG&W and apparently accepted by the PUC as correct.[7] Once again, we decline to conclude that *this*

7. The PUC order expressly accepted PG&W's figure of $78,011,302 for undepreciated original cost. Because PG&W's estimate of $6,924,485 of accrued depreciation applicable to original cost was discussed simultaneously with the estimates of accrued depreciation applicable to trended costs, the PUC order is vague as to acceptance or rejection of this figure. However, since the

figure alone establishes an abuse of discretion per se, because there may exist a situation, however improbable, in which stability of prices for materials, increased labor productivity, enhanced technological efficiency, or some combination thereof would make reproduction cost sufficiently low that a reasonable fair value figure may exceed net original cost by a lesser percentage. Where, however, there is no direct evidence in the record of such a low reproduction cost and no evidence suggesting the presence of the listed economic factors even approaching the extent necessary to produce such a low ratio of fair value to net original cost, the conclusion becomes inescapable that the PUC arbitrarily and capriciously ignored the evidence or its duty under the law in setting fair value.

In the present case, the divergence between PG&W's asserted fair value and that set by the PUC appears to be rooted in a disagreement over trended costs. Before examining the PUC's specific criticisms of PG&W's trending of costs, it will be helpful to make several computations to illustrate the magnitude of the PUC's disagreement with PG&W's trended cost estimates.

Traditionally, the PUC fixes fair value at a point near the average of original cost depreciated and trended original cost depreciated. *See Johnstown v. Pennsylvania Public Utility Commission*, 184 Pa. Superior Ct. 56, 133 A. 2d 246 (1957); *Pittsburgh v. Pennsylvania Public Utility Commission*, 174 Pa. Superior Ct. 363, 101 A. 2d 761 (1954); *Orlosky v. Pennsylvania Public Utility Commission*, 171 Pa. Superior Ct. 409, 89 A. 2d 903 (1952). If the PUC had used this approach in the present case, it would have had to employ a trended cost depreciated

7. (Cont'd.)
PUC directed no criticism at this estimate of accrued depreciation applicable to original cost, we will assume it was accepted for purposes of computing the percentage figure in the text.

figure of $103,345,023 in order to arrive at a fair value of $87,700,000. This would reflect a downward adjustment in PG&W's trended cost figure amounting to $94,743,071. If the PUC had computed fair value by weighting trended cost depreciated at one-third and original cost depreciated at two-thirds of the total, a fair value of $87,700,000 could be arrived at only by employing a trended cost depreciated figure of $118,990,032. This represents a downward adjustment of PG&W's trended figure amounting to $79,108,062. If, as seems to be the case, the PUC had made no actual revision of PG&W's figures but instead exclusively used weighting of the original cost depreciated and trended original cost depreciated figures submitted by PG&W to arrive at the $87,700,000 fair value figure, PG&W's trended cost figure would have to be assigned a weight of approximately only one-eighth in computing the fair value. As these figures indicate, the fair value set by the PUC reflects very nearly a complete rejection of the trended cost figures submitted by PG&W.

The PUC's rejection of PG&W's figures clearly stems from criticisms of two of the indices used in trending. First, the PUC rejected PG&W's use of the "Handy-Whitman Waterworks Index for reinforced concrete" in trending the concrete and masonry components of its reservoirs. In its order, the PUC stated:

> "In consideration of the fact that the depreciated original cost of respondent's reservoirs comprise nearly 20 percent of the total depreciated original cost of respondent's depreciable property, we believe that respondent's engineer should have attempted to develop his own index using component weightings applicable to reservoir construction. Most preferably, respondent's engineer should have used information from respondent's recent reservoir construction experience, if possible.

"Our position regarding respondent's use of the Handy-Whitman Index is based upon the following points: (1) It could not be established that the Handy-Whitman Index was designed to be applied to dam construction. Respondent's engineering witness stated on the record that the application for which this index was developed is not designated by Handy-Whitman. (2) The Handy-Whitman Index contains no element of contractor's equipment in its development. We consider it unlikely that a concrete dam could be constructed without the use of contractor's equipment. (3) The labor component of the Handy-Whitman Index accounts for 65 percent of the index weight, of which approximately one-half is represented by common labor. Respondent's engineer stated on the record that the amount of common labor used in concrete or masonry dam construction would be negligible. (4) The Handy-Whitman Index is not available prior to the year 1912, and a significant amount of respondent's reservoir construction occurred before that year. For these reasons we do not consider respondent's use of the Handy-Whitman Index in trending the concrete and masonry elements of respondent's reservoirs to be completely appropriate."

Second, the PUC rejected PG&W's choice of an index to trend certain labor costs:

"For the purpose of developing composite indexes to trend the material and installation labor for certain portions of respondent's property, such as pumps, motors, and pump and filter piping, respondent's engineer has chosen the Engineering News-Record (E. N. R.) 20-Cities Index to represent the labor element in the composite indexes. In recent

> decisions regarding water utilities, this Commission has held the opinion that, insofar as possible, company, local or at least Pennsylvania material and labor rates should be used in the development of indexes to reflect as accurately as possible the experience of the company. The record in these proceedings reveals that, in developing indexes to be applied to the aforementioned elements of respondent's property, respondent's engineer made no attempt to develop skilled labor indexes from wage rates in or around respondent's area due to the relative unimportance of the property involved. Regardless of the signficance of the property to be trended, the position of the Commission remains unchanged. Consequently, we do not consider respondent's use of the E. N. R. 20-Cities Index for skilled labor to be completely appropriate in these proceedings."

These were the only two significant criticisms of PG&W's figures and, as noted, the latter related to property of "relative unimportance". At no point in the order did the PUC attempt to explain, by way of other evidence, alternative indices, or calculations, how it arrived at its selection of fair value after rejecting PG&W's trended figures. It simply noted that it would take its criticisms "into consideration" in the conclusion of its order.

Because the PUC's criticism of PG&W's trending of reservoir construction costs involved nearly 20 percent of the total depreciated original cost of PG&W's depreciable property, we are certain that a fair value finding substantially lower than the $135,076,535 asserted by PG&W could normally be sustained as a reasonable exercise of the PUC's judgment. In the present case, however, the PUC's finding of fair value reflects a 35 percent downward adjustment from PG&W's asserted fair value. As our

examination of the record discloses, the reservoir property of PG&W constituted approximately only 24 percent of the total estimate of depreciated *trended* original cost at five-year average prices. In the absence of any other significant criticisms of PG&W's figures and the absence of any evidence of other factors tending to belie PG&W's estimates and evidence of cost and fair value, the setting of fair value at *as low a level* as was done by the PUC would appear to be both unsupported by the evidence and beyond the bounds of its discretion.[8] We are convinced of the accuracy of this conclusion by the presence of one additional consideration in this case.

As noted earlier, PG&W was party to a water service rate case before this Court in early 1975. *PG&W I, supra.* That case had its origins in the filing by PG&W, on January 30, 1973, of supplements to its water tariffs based on a test year ended September 30, 1972. The case was before the PUC in 1973 and 1974 and resulted in a PUC order dated July 9, 1974. Evidence was presented by both PG&W and the complainants as to all measures of value. After considering all of the evidence, the PUC set a fair value, as of September 30, 1972, at $102,000,000. On appeal to this Court, in an opinion dated May 27, 1975, we held that while our review led us to believe that the PUC's finding of fair value was low, it could not be said to be an abuse of discretion per se. *PG&W I, supra* at 227, 341 A. 2d at 247-48. We also concluded,

8. Even if the PUC found trended reservoir construction costs to be zero, PG&W's other trended costs would still total over $150,000,000. Our prior discussion of the type of "adjustments" to the trended cost figures needed to reach a fair value of $87,700,000 indicates that even this large an adjustment would not be sufficient to reach that figure. For example, a fair value set at the average of $72,054,977 and $150,000,000 would be $111,027,488. It is thus obvious that an extremely large additional and unexplained "adjustment" must have been made by the PUC.

however, that the PUC had erred in the exclusion of $2,558,634 from the original cost measure of PG&W's rate case, a sum representing a damage settlement payment by the Pennsylvania Department of Transportation to PG&W for damages to one of its watersheds. We remanded the case to the PUC for recomputation of the rate base and such other measures of value as were effected by inclusion of this sum in the rate base.

It is true that orders of the PUC fixing rates are not res judicata nor are its findings of fair value conclusive for the future since the law contemplates a reexamination of these matters as conditions change. *Duquesne Light Co. v. Pennsylvania Public Utility Commission,* 176 Pa. Superior Ct. 568, 107 A. 2d 745 (1954); *Philadelphia v. Pennsylvania Public Utility Commission,* 173 Pa. Superior Ct. 38, 95 A. 2d 244 (1953); *Beaver Valley Water Co. v. Pennsylvania Public Utility Commission,* 140 Pa. Superior Ct. 297, 14 A. 2d 205 (1940); *Baltimore and Ohio Railroad Co. v. Pennsylvania Public Utility Commission,* 135 Pa. Superior Ct. 20, 4 A. 2d 628 (1939). Moreover, as we stated in *PG&W I, supra* at 225, 341 A. 2d at 246-47, "the Commission's responsibility is to determine fair value as of the end of the test period used in *this* rate case. What may have been fair value at another time is not necessarily fair value 15 years later." (Emphasis in original). Also in *PG&W I,* we concluded that a utility which seeks to use a finding of fair value from a previous case as a minimum or starting point for the PUC's determination of fair value has the burden of proving that factual circumstances have not changed subsequent to the previous rate case. *PG&W I, supra* at 224-25, 341 A. 2d at 246-47. In sum, although prior findings of fair value are not conclusive, we do believe that where a utility can show the nonoccurrence of change in factual circumstances having the effect of reducing the value of its property and where

there has been no showing that the PUC acted under some mistake as to fact or committed an error of law in the previous rate case involving the utility, the previous finding of fair value provides a limit on the range of the PUC's discretion in setting fair value in the subsequent rate case. *Cf. Baltimore and Ohio Railroad Co. v. Pennsylvania Public Utility Commission, supra* at 24, 4 A. 2d at 630; *Cheltenham & Abington Sewerage Co. v. Public Service Commission,* 122 Pa. Superior Ct. 252, 264-65, 186 A. 149, 156 (1936). (The cited authorities place the converse burden upon complainants seeking in a second proceeding to challenge the legality of rates set in a previous proceeding to which they were a party).

Here, only two years had elapsed between the ends of the test years upon which the filings of supplements were based in *PG&W I* and the present case. In the present case, PG&W introduced detailed cost and fair value figures and no contradictory evidence was adduced by the PUC or any complainant. The PUC's criticism of PG&W's use of the Handy-Whitman Index to trend reservoir construction was a repetition of an *identical criticism* made by the PUC in *PG&W I.* Moreover, two significant criticisms voiced in the PUC orders involved in *PG&W I,* relating to the component percentages used in developing indices for trending pipeline installation and reservoir earthwork costs and to useful life estimates for certain pipelines, were corrected to the PUC's satisfaction in the present case. Our review of the record in the present rate proceedings and our examination of *PG&W I* convinces us that PG&W has adequately shown the absence of any change in factual circumstances which would justify any substantial downward deviation from the fair value finding in *PG&W I.* There has been no showing that the PUC acted under a mistake of fact or committed an error

of law which resulted in the fair value finding of $102,000,000 made in *PG&W I* being *excessive*. In fact, this Court ordered the PUC in *PG&W I* to add $2,558,634 to the rate base. Additionally, PG&W made well over $3,000,000 at original cost in additions to its plant between the ends of the test years involved here. In view of all of these factors, we find it incredible that the PUC could set $87,700,000 as the fair value in the present proceedings. We can only conclude that it was the result of a manifest abuse of discretion amounting to an error of law.

Normally, we would remand this case to the PUC for further proceedings. However, assuming without deciding that the fair rate of return set by the PUC at 8.53 percent is correct, we note that a fair value finding of $95,157,104 is sufficient to support the reasonableness of the entire proposed rate increase. Based upon the considerations set forth in the immediately preceding portion of this opinion, it is our conclusion that under no permissible view of the facts or law involved in this case could the PUC reasonably conclude that the fair value of PG&W's property used in providing water service to the public is less than that value necessary, when multiplied by a rate of return of 8.53 percent, to support as just and reasonable the entire rate increase proposed by PG&W.[9]

In view of our conclusion, we will remand the case to the PUC with an order directing the PUC to enter an order dismissing the complaints and allowing, as perma-

9. Where confiscation is alleged and shown, the Court may make its own finding of fair value. *Duquesne Light Co. v. Pennsylvania Public Utility Commission, supra; Solar Electric Co. v. Pennsylvania Public Utility Commission*, 137 Pa. Superior Ct. 325, 9 A. 2d 447 (1939). Additionally, where the fair value is clearly in excess of that sufficient to support rates as reasonable, no specific finding of fair value or rate of return is necessary. *Johnstown v. Pennsylvania Public Utility Commission, supra.*

nent rates, each of the rates proposed in the supplements filed by PG&W.[10]

In view of the foregoing, we need not consider PG&W's challenge to the PUC's finding as to fair rate of return. Finally, we note that the PUC attempted to justify its overall decision on the ground that it permitted a 17.28 percent return on "original cost common equity invested solely in water operations (excluding acquisition adjustment of $14,600,000)." Although we are uncertain of the meaning of this phrase and its role in rate proceedings, we are certain that "original cost common equity" is not a proper measure of the reasonableness of rates insofar as it employs exclusively an original cost measure of value. The standard of a "fair return on the fair value of property used and useful in the service of the public," remains as the ultimate standard governing rate-making in this Commonwealth.[11]

/s/ JAMES S. BOWMAN
James S. Bowman, President Judge

Judge Kramer did not participate in the decision in this case.

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10. Pa. R. A. P. 1561 provides:

"(a) General rule.—The court may affirm, modify, vacate, set aside or reverse any order brought before it for review, and *may remand the matter and direct the entry of such appropriate order,* or require such further proceedings to be had, *as may be just under the circumstances.*" (Emphasis added).

11. This case, following the death of Judge Kramer, who had originally been assigned to it, was reassigned to President Judge Bowman.

IN THE
COMMONWEALTH COURT OF PENNSYLVANIA

No. 1523 C. D. 1976

PENNSYLVANIA GAS AND WATER COMPANY—
WATER DIVISION,
Petitioner

v.

COMMONWEALTH OF PENNSYLVANIA,
PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Respondent

Order

Now, December 21, 1977, the order of the Pennsylvania Public Utility Commission at R. I. D. No. 209 is hereby reversed insofar as it disallowed Supplement No. 23 to Tariff Water—Pa. P. U. C. No. 3—Spring Brook Rate Area and Supplement No. 24 to Tariff Water—Pa. P. U. C. No. 4—Scranton Rate Area.

It is further ordered that the Commission issue an order dismissing the complaints filed in this matter and allowing the above named supplements and designating them as permanent rates.

Insofar as the Commission's order at R. I. D. No. 209 designated as permanent rates the rates filed under Supplement No. 22 to Tariff Water—Pa. P. U. C. No. 3—Spring Brook Rate Area and Supplement No. 23 to Tariff Water—Pa. P. U. C. No. 4—Scranton Rate Area, the order is affirmed.

/s/ JAMES S. BOWMAN
James S. Bowman, President Judge